SUPREME COURT, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 996

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
HARRY FIELDS,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
SAMUEL H. KING,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
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v.
RITA VERTELNEY, Special Administratrix, etc.,
Respondent.

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Petitioners,
v.
GORDON M. COHEN,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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Opinions Below

The opinion of the Court of Appeals (A. 1-53) is reported in CCH FED. SEC. L. REP. ¶92,005.

Questions Presented

Respondents do not dispute that the questions set forth in Petition 2 are those Petitioners attempt to present. However, in assessing the merits of whether certiorari should be granted, the Court should be aware that most of the "questions presented" would not be reached even if certiorari were granted: Petitioners' Questions A and C are not, in fact, "presented" because they were not preserved below (see pages 17-18 and 22, *infra*); Petitioners' Question D was a mere alternative ground in the courts below (see pages 15-16, *infra*); and Petitioners' Question F is based upon nothing more than a gross mischaracterization of isolated language in the Court of Appeals opinion (see pages 30-31, *infra*).

Statement

The following additional facts are essential to due consideration of the Petition. The corporate Petitioner is the successor of Lakeside Plastics and Engraving Co. ("LPE"), a Minnesota company (III R. 1), with offices in Duluth (R. 502), and Lakeside Plastics Sales Co. ("LPS"), an Illinois company (III R. 4), with offices in Chicago (R. 460). (III R. 19-21.)

Petitioners Benn Myzel and Philip Myzel, acting on behalf of the other individual Petitioners and of the predecessor to the corporate Petitioner, purchased stock in LPE from Respondents by use of misrepresentations and omissions of material facts. Since Petitioners do not dispute the sufficiency of the evidence to support recovery except with respect to the purchase from Respondent Vertelney, only the facts as to that purchase will be stated.

Vertelney bought his stock in LPE on the strong recommendations of his good friend, Petitioner Benn Myzel (R. 303, 305). Benn Myzel was a cousin (S.R. 310) of and "consultant and advisor" to LPE's president and "intimately knew" LPE's affairs (R. 524). LPE's records showed Vertelney, who had not been a director since 1949 (R. 475-76), was re-elected to the board in 1952 (R. 476). The evidence is uncontroverted that only one meeting occurred in 1953 prior to his sale of stock, and that meeting lasted only 35 minutes (R. 479-80).

About a month before Vertelney sold his stock, Petitioner Zelman Levine approached him and asked if he wanted to sell his stock, and Vertelney said he did not (R. 316).

Petitioner Phil Myzel, acting as "agent" for Benn Myzel (S.R. 319, 322), purchased Vertelney's stock late in 1953 (R. 314). Phil Myzel made the following statements to Vertelney during the transaction:

> "It looks like these guys [LPE] are having kind of a rough time. Maybe you'd like to dispose of your stock" (R. 314).
>
> "It doesn't look like they are going to do very much with that Lakeside Plastics, and Benn wants to get rid of some of his stock, too, because he doesn't think they are going anywhere. He thought maybe you should get rid of it, too" (R. 315).
>
> "Heck, the thing is going to go bankrupt. They are not doing too good and it looks like Benn is going to get out and it would be a good idea for you to get out, too" (R. 315-16).

When Vertelney asked, "Does he [Benn Myzel] know so much more about what is going on out there than I do?", Phil Myzel answered:

> "Yes. These guys out there, they seem to be giving him the shim-sham. They are not giving straight answers at all. He thinks they are liable to go broke altogether. You'd be smart to sell your stock" (R. 315).

Aside from these negative observations, Phil Myzel admitted that he disclosed no information to Vertelney about how the company was actually doing (S.R. 396).

The statements that Benn Myzel did not think the LPE stock was "going anywhere" and thought LPE was "liable to go broke altogether and was therefore going "to get rid of some of his stock" and was "going to get out" were untrue. In fact, Benn Myzel testified he was always optimistic about the company (R. 612, 636), always felt it had a bright future and would be a success, and knew that "business was going up as far as sales" (R. 612). He never "got out"—he was employed by the corporate Petitioner up through the time of trial (R. 524, 569).

Vertelney made up his mind that

> "* * * it didn't look like a very good investment anymore, especially if Benn was going to get out of it because he was the original promoter of this thing. He is the one that pushed it so far, I would have thought that if he would get out, I better get out, too" (R. 315).

Shortly after Vertelney sold his stock, he saw Benn Myzel on occasion, and Benn would state that LPE was "still not doing too good," and was doing "pretty lousy" (R. 319). Between 1953 and 1962, Vertelney did not discuss LPE with anyone (R. 320) and did not suspect he had sold for too small a price until 1962 (R. 321).

Benn Myzel later transferred the stock to LPS (III R. 8-11). It was uncontradicted that LPS sent checks in

payment for the stock from its offices in Chicago, Illinois, to Benn Myzel in Minnesota (R. 711-12; see R. 455-58). LPE gave Benn Myzel a $35,000 contract for his services as a "management consultant" at least partly because of his having obtained the stock (R. 139-41, 536). The shares were subsequently acquired by LPE and retired (III R. 20).

The case was submitted to the jury, and the following general instructions were given by the trial court relating to the nature of the factual findings required:

> "The main questions of fact to be decided by you are:
>
> "1. Did the defendants directly or indirectly use manipulative or deceptive conduct in buying the stock of each of the plaintiffs?
>
> "2. If there was such conduct, did the defendants use any means, or instrumentality of interstate commerce or the mails in doing so?
>
> "3. If there was such conduct on the part of the defendants, did this conduct consist of the making of untrue statements as to a material fact or did it consist of omission to state a material fact which was necessary to prevent the statement or statements that were made misleading? Or did it consist of the failure to disclose a known fact or facts which the defendants should reasonably have known would be important to the plaintiffs in determining the value of the stock they held?
>
> "4. If there were misrepresentations or omissions, were they made with the intent of inducing the plaintiffs to sell their stock?
>
> "5. If there were misrepresentations or omissions, did they relate to material facts?
>
> "6. Did each plaintiff rely on the claimed misrepresentations or omissions?" (R. 782-83).

The trial court then instructed as to jurisdiction:

> "It is for you to determine whether an instrumentality of interstate commerce, such as the telephone, or the mails, was used by a defendant, or defendants, in connection with the purchase of the stock of a particular plaintiff" (R. 785).

as to corporate liability:

> "Reference has been made to defendant Lakeside Industries, Inc., as a successor corporation to Lakeside Plastics & Engraving Company and other companies.
>
> "The law holds a corporation responsible for all unlawful acts of its directors, officers, employees or other agents, provided such unlawful acts are done in the ordinary course of their employment or in the ordinary course of the corporation's business" (R. 789).

and as to damages (inter alia):

> "If you believe that the net result of full disclosure would have been that a plaintiff would have retained his stock as an investment rather than selling it to defendants at a higher price, you should consider the subsequent increases in the value of the stock over what you consider a reasonable period as part of the losses of a plaintiff which he is entitled to recover.
>
> "What constitutes a reasonable period is for you to determine upon all the facts of this case. You should bear in mind that the statute is not intended to provide investors with an insurance policy against market changes. It does, however, seek to prevent those who have engaged in fraudulent or illegal conduct from benefiting by that conduct" (R. 793).

The trial court twice read to the jury §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j and Rule 10b-5 (R. 784-85).

Petitioners objected to the trial court's instruction on damages to the extent it authorized damages measured by the value of the shares at any time after the date of sale, and to the trial court's refusal to give their requested instruction restricting consideration of facts bearing on valuation to the date of sale (R. 802, 823-24). Petitioners also objected to the trial court's instruction that an intrastate communication by telephone could constitute use of an instrumentality of interstate commerce (R. 801). Finally, Petitioners objected to the trial court's failure to give their requested instructions that to find liability, the jury had to find that the misrepresentations or omissions were made with knowledge of their false or misleading nature, and with the intention to deceive (R. 834, 836).

Although an instruction on the statute of limitations was requested (R. 839), and one was given (R. 793-94), Petitioners, consistent with their view that laches was not an available defense in an action tried to a jury (R. 62; S.R. 11), requested no instruction on laches, and did not object to the trial court's failure to give an instruction on that defense.

The jury returned verdicts for Respondents and against Petitioners. In denying Petitioners' motions for judgment notwithstanding the verdict or for a new trial, the trial court held, inter alia, on the matter of jurisdiction, that:

> "The evidence established that the mails were used in the transfer of payments for stock to Benn Myzel from LPS. and this meets the statutory requirement" (A. 71).

Judgments were entered and Petitioners appealed to the Court of Appeals for the Eighth Circuit, asserting, inter alia, that the trial court erred in instructing that intrastate use of the telephone is use of an instrumentality of interstate commerce (App. Br. 83-85); in holding that the corporate defendant could be held liable (App. Br. 78-79); and in allowing damages to be tested by the value of the stock at any time after the time of sale (App. Br. 51-71). Before the Court of Appeals, Petitioners did not assert any error in the failure to instruct the jury concerning laches as a defense, nor did they argue that the existence of scienter was a finding prerequisite to liability.

The Court of Appeals held that jurisdiction under the Act and Rule 10b-5 was sustained both by interstate delivery of checks and by intrastate use of the telephone (A. 2-5); that the corporate Petitioner was properly held liable (A. 49-51); that Respondent Vertelney was properly accorded recovery (A. 21-25); and that the measure of damages was proper (A. 32-49). Although the issues were not properly presented, the Court of Appeals also expressed its view that the defense of laches, "an issue upon which neither the judge or the jury passed," was "not applicable where the action was properly tried at law to a jury" (A. 35), and that "Proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made, is not required under Section 10(b) of the [Securities Exchange] Act" (A. 19).

Summary of Argument

There are no "special and important reasons," within the meaning of Rule 19, for granting review. Petitioners present no "real and embarrassing conflict of opinion and

authority." *Layne & Bowler Corp.* v. *Western Oil Works, Inc.*, 261 U. S. 387, 393 (1923). The case-by-case development of the relevant law regarding the issues herein is satisfactory. See *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912, 918 (1950).

A. Jurisdiction

The holding that §10(b) jurisdiction may be based on intrastate telephone use was only an alternative ground for sustaining jurisdiction (A. 5, 71). It thus provides a question which is presented "abstractly" rather than "in the context of meaningful litigation." *The Monrosa* v. *Carbon Black Export, Inc.*, 359 U. S. 180, 183, 184 (1959).

There is no conflict with any court of appeals decision. With the exception of *Rosen* v. *Albern Color Research, Inc.*, 218 F. Supp. 473 (E.D. Pa. 1963), the authorities accord with the alternative holding herein. See *Nemitz* v. *Cunny*, 221 F. Supp. 571 (N.D. Ill. 1963); *Bredehoeft* v. *Cornell*, 260 F. Supp. 557 (D. Ore. 1966).

B. Laches

(1) *Preservation.* Petitioners did not properly preserve the laches issue in either court below. *Quicksall* v. *Michigan*, 339 U. S. 660, 663 n. 3 (1950). They requested no instruction on laches and did not object to the omission of such an instruction, F.R. Civ. P. 51; *Lopez* v. *United States*, 373 U. S. 427, 436 (1963); *Howitt* v. *United States*, 328 U. S. 189, 191 n. 3 (1946); they did not assert laches as a defense before the Court of Appeals. *California* v. *Taylor*, 353 U. S. 553, 556 n. 2 (1957).

(2) *Facts.* The record contains no facts showing any evidentiary basis to support a laches defense. Laches requires not only evidence of delay, but proof of prejudice.

Gutierriz v. *Waterman S.S. Corp.*, 373 U. S. 206, 215-16 (1963).

(3) *Conflict.* There is no conflict with any court of appeals decision. *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962) does not hold to the contrary of the present Court of Appeals' statement. The Court's statement is correct. *Straley* v. *Universal Uranium & Milling Corp.*, 289 F. 2d 370 (9th Cir. 1961); see *Holmberg* v. *Armbrecht*, 327 U. S. 392, 395 (1946).

C. Scienter

This Court should refuse to review Petitioners' "scienter" issue for the following reasons:

(1) Petitioners did not present this issue to the Court of Appeals. *California* v. *Taylor*, 353 U. S. 553, 556 n. 2 (1957).

(2) The testimony of the Petitioners who made the representations showed as a matter of law that each knew that the opposite of the impressions produced by the misrepresentations or omissions was true (R. 612, 636, 683; S.R. 395).

(3) There is no conflict with any court of appeals decision. The court in *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951) did not state that "scienter" was required, but that "fraud" was. The authorities cited by the *Fischman* court show that it did not mean "fraud" as understood at common law, where "scienter" was required. Several district courts in the Second Circuit agree that "scienter" is not required. *Miller* v. *Steinbach*, 268 F. Supp. 255, 279 (S.D.N.Y. 1967); *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 277-78

(S.D.N.Y. 1966); *Dack* v. *Shanman,* 227 F. Supp. 26, 29 (S.D.N.Y. 1964). The reasoning of the cases holding "scienter" not required (*e.g., Ellis* v. *Carter,* 291 F. 2d 270 (9th Cir. 1961); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.,* 187 F. Supp. 14 (W.D. Ky. 1960) *reversed on other grounds,* 307 F. 2d 242 (6th Cir. 1962)) is clearly correct and will be adopted by courts of appeal.

(4) *Satisfactory Development.* Because of the many situations to which §10(b) can be applied and the range of proof requirements which might be formulated, the Court should have the aid of the thinking of as many courts of appeal as possible before considering this issue. See *Maryland* v. *Baltimore Radio Show, Inc.,* 338 U. S. 912, 918 (1950).

D. Corporate Petitioner's Liability

As to the routine issue of the corporate Petitioner's liability, Petitioners do not assert a conflict. Petitioners otherwise show no reason justifying this Court's consideration.

E. "Grossly Negligent Plaintiff"

The argument that Respondent Vertelney was "grossly negligent" is based upon a false premise. A reading of the opinion (A. 22-25) shows clearly that the Court of Appeals affirmed the jury finding that Respondent Vertelney acted reasonably, and directed its "grossly negligent" language only to the hypothetical situation which would exist had the representations concerned only financial condition and business affairs.

F. Damages

The holding on damages does not conflict with any court of appeals decision. *Estate Counselling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962), applying the "out-of-pocket" rule to a *purchaser* of stock in no way governs §10(b) cases brought by *sellers* of stock. The purchaser loses only the definite amount of money paid. The seller who would have retained his stock loses the appreciation in value; the Court's holding correctly recognizes this difference. The innocent party rather than the wrongdoer should receive such appreciation. *Janigan* v. *Taylor*, 344 F. 2d 781 (1st Cir.), *cert. denied*, 382 U. S. 879 (1965).

Reasons for Denying the Writ

Introduction

Rule 19 emphasizes that the discretionary power to grant review on certiorari in federal cases will be exercised "only where there are special and important reasons therefor." There are no "special and important reasons" for granting review in this case.

Petitioners' references (Petition 10) to the "significant impact" of the Court of Appeals decision upon themselves, and to the amount of the verdict and the identity of some of the parties, are totally inapposite. The purpose of certiorari is to serve the "interest of the law, not the interest of the particular parties," and "[i]t is not the importance of the parties or the amount involved that is controlling." Mr. Chief Justice Hughes, Address to American Law Institute, May 10, 1934, in HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1395,

1396 (1953). Certiorari is concerned only with "questions whose resolution will have immediate importance far beyond the particular facts and parties involved." Mr. Chief Justice Vinson, Address to American Bar Association, September 7, 1949, in HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1403, 1404-05 (1953). See *Rice* v. *Sioux City Memorial Park Cemetery,* 349 U. S. 70, 74 (1954).

Far from presenting any "real and embarrassing conflict of opinion and authority between the * * * courts of appeal," *Layne & Bowler Corp.* v. *Western Well Works, Inc.,* 261 U. S. 387, 393 (1923), Petitioners, as to each issue, assert either no court of appeals conflict at all (see Petition 19-20, 20-21), or at most, an imaginary inconsistency. None of the questions involved herein is, within the meaning of Rule 19, "an important question of federal law which has not been, but should be, settled by this Court." Rather, most are questions which have never previously been treated by a court of appeals. All are questions which are just now receiving treatment by the lower courts (many at the pleading stage).[1]

There is nothing to indicate that the case-by-case development of the relevant law by the lower courts is unsatisfactory. As stated by Mr. Justice Frankfurter

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1. "[M]ost of 10b-5 law (and, until recent years, practically all of it) is from the District Courts." BROMBERG, SECURITIES LAW: FRAUD §1.3(2) (1967). This is not surprising. The Securities Exchange Act of 1934, 48 Stat. 881 (1934); 15 U.S.C. 78 et seq., is approximately 34 years on the books. Rule 10b-5 was not promulgated until 1942. Exchange Act Release No. 34-3230 (May 21, 1942), 13 FED. REG. 8177. Civil liability for violation of Rule 10b-5 goes back no further than *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), and lower courts were still holding no civil recovery under § 10(b) as late as 1954. *Beury* v. *Beury*, 127 F. Supp. 786 (S.D. W. Va. 1954), *appeal dismissed*, 222 F. 2d 464 (4th Cir. 1955). (Court of Appeals stated disapproval in dicta).

in his opinion respecting denial of certiorari in *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912 (1950):

> "It may be desirable to have different aspects of an issue further illumined by the lower courts. Wise adjudication has its own time for ripening." 338 U. S. at 918.

But an overriding consideration in exercising the discretionary power to grant review is the question of what ultimately *can* be decided by the Court if certiorari should issue, *i.e.*, do the questions presented have the procedural credentials qualifying them for review. Most of the points asserted in this case do not. Two of the points were not preserved by Petitioners in the courts below. One was merely an alternative ground. Another is based on no other foundation than a gross mischaracterization of isolated language in the Court of Appeals opinion.

Respondents feel that the matters asserted by Petitioners may be treated conveniently in the following order:

(a) Jurisdiction under the Securities Exchange Act.

(b) Laches.

(c) Scienter.

(d) Liability of corporate defendant.

(e) "Grossly negligent plaintiff."

(f) Measure of damages.

A. The decision below, alternatively basing jurisdiction or intrastate telephone use, does not conflict with any court of appeals decision.

Petitioners question the view of the district court and of the Court of Appeals that intrastate telephone use can

supply a basis for jurisdiction under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 (Petition 19-20). The Court should not grant review of this issue because it was but an alternative ground for sustaining jurisdiction. The trial court, in accordance with uncontradicted testimony of one of the Petitioners (R. 711; see R. 455-56), correctly stated that:

> "The evidence *established* that the mails were used in the transfer of payments for stock to Benn Myzel from LPS, and this meets the statutory requirement" (A. 71). [Emphasis added.]

Likewise, the Court of Appeals found the established interstate transactions sufficient in themselves for sustaining jurisdiction:

> "But there exists additional grounds to sustain jurisdiction. It is the rule that where any interstate use is made to perpetuate the original fraudulent concealment or transaction, even though not part of the original solicitation or inducement of sale involved, then nevertheless the subsequent use of interstate facilities in furthering the scheme is sufficient to establish federal jurisdiction. *Creswell-Keith, Inc.* v. *Willingham,* 264 F. 2d 76, 80, 82 (8 Cir. 1959); see also *Thomas* v. *United States,* 227 F. 2d 667, 670 (9 Cir. 1955) [*cert. denied,* 350 U. S. 911 (1955)] [use of automobile]; *Ellis* v. *Carter,* 291 F. 2d 270, 274 (9 Cir. 1961) [use of plane]; cf. *Boone* v. *Baugh,* 308 F. 2d 711 (8 Cir. 1962).
>
> "[Respondents] * * * contended that they were fraudulently induced to sell their stock to the [Petitioners], that the purchases were made by parties (the Myzels) other than the true buyers (the Levines) and that an Illinois corporation owned by some of the [Petitioners] was used as a conduit of

> concealment. The transfers of the stock to the Illinois corporation, although occurring several months and even years later, involved the delivery of checks written by the Illinois corporation on Chicago, Illinois banks to a Minnesota citizen. Cf. *Little* v. *United States,* 331 F. 2d 287 (8 Cir. 1964) [*cert. denied,* 379 U. S. 834 (1964)]. Thus, under [Respondents'] * * * theory, there was also sufficient evidence of interstate transactions to sustain jurisdiction" (A. 5).

The foregoing shows that resolving the jurisdictional question posed by Petitioners would not affect the result in this case. It would provide an interesting intellectual exercise but an academic result, and a waste of judicial energy. See *Rice* v. *Sioux City Memorial Park Cemetery,* 349 U. S. 70, 74 (1955). While it may have been proper for the Court of Appeals to pass upon both grounds, this Court decides questions only "in the context of meaningful litigation" and resolution of the question here presented can well "await a day when the issue is posed less abstractly." *The Monrosa* v. *Carbon Black Export, Inc.,* 359 U. S. 180, 183, 184 (1959). See *Tomoya Kawakita* v. *United States,* 343 U. S. 717, 731 (1952).

Not only is the jurisdictional question academic, it is not the subject of any other court of appeals decisions. And with the exception of one district court decision, *Rosen* v. *Albern Color Research, Inc.,* 218 F. Supp. 473 (E.D. Pa. 1963), the authorities uniformly agree that intrastate telephone use is a basis for §10(b) jurisdiction. See *Nemitz* v. *Cunny,* 221 F. Supp. 571 (N.D. Ill. 1963); *Bredehoeft* v. *Cornell,* 260 F. Supp. 557 (D. Ore. 1966) (alternative ground); *Lennerth* v. *Mendenhall,* 234 F. Supp. 59, 63 (N.D. Ohio 1964) (similar language in §5 of the Securities Act of 1933, 15 U.S.C. §77e); 5 B.C. Ind. & Com. L. Rev. 466 (1964).

The lower courts need no guidance to see the error made by the district court in *Rosen* v. *Albern Color Research, Inc., supra,* and to develop the correct rule accordingly, In *Rosen,* the court relied, as do Petitioners, upon *Minneapolis & St. L. R.R.* v. *Winters,* 242 U. S. 353, 357 (1917). This approach ignores the fact that the issue in that case was whether, under the Federal Employer's Liability Act, 35 Stat. 65, 45 U.S.C. §51, the plaintiff was *employed in* interstate commerce at the time of injury, not whether an *instrumentality of* interstate commerce was involved. The approach also ignores this Court's many decisions since *Winters* that Congress may regulate intrastate activity if it involves an instrumentality of interstate commerce. *Alstate Constr. Co.* v. *Durkin,* 345 U. S. 13 (1953) (making product for instrastate application to interstate roads); *Overstreet* v. *Northshore Corp.,* 318 U. S. 125 (1943) (operation of toll road and bridge located wholly within one state); *Weiss* v. *United States,* 308 U. S. 321 (1939) (prohibition of interception and divulgence covers intrastate telephonic messages).

B. The defense of laches was not presented procedurally or factually; moreover, the Court of Appeals statement thereon does not conflict with any court of appeals decision.

The Petition asserts at page 18 that "the court below erred in holding that the defense of laches was not applicable to a Rule 10b-5 cause of action 'properly tried at law to a jury'" (A. 35).

(1) *Preservation.* It first should be noted that Petitioners did not, at any stage of the proceedings, properly preserve the issue asserted. As the Court of Appeals

stated, whether Petitioners were entitled to invoke the defense of laches was "an issue upon which neither the judge or the jury passed" (A. 35). Petitioners made no request to the trial court to instruct the jury on laches or unreasonable delay, even though they submitted a requested instruction on the statute of limitations (R. 839). Nor did they object to the trial court's omission of an instruction on laches. F.R. Civ. P. 51 states in relevant part:

> "No party may assign as error the giving or failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection."

This is a classic case of waiver under Rule 51. Raising laches as a defense at this juncture is totally improper and should be disregarded by the Court. *Lopez* v. *United States,* 373 U. S. 427, 436 (1963); *Howitt* v. *United States,* 328 U. S. 189, 191 n. 3 (1946).

Nor did Petitioners assert the existence of laches as a defense before the Court of Appeals. At most, they posed a laches-like argument, since abandoned, which they believed relevant to their argument on the measure of damages. (Appellant's Brief 65; see Appellant's Reply Brief 16). The fact that the Court of Appeals proceeded to express its opinion on laches does not resurrect for Petitioners an issue which they have already waived. Because the issue was not properly raised in the Court of Appeals is reason enough to refuse to consider it in this Court, *California* v. *Taylor,* 353 U. S. 553, 556 n. 2 (1957); certainly Petitioners may not assert it here when they have not properly preserved it in *either* court below. *Quicksall* v. *Michigan,* 339 U. S. 660, 663 n. 3 (1950).

(2) *Facts.* The obvious reason for Petitioners' failure to preserve the issue of laches is the absence of any facts showing an evidentiary basis to support the defense. Laches cannot now be raised by Petitioners in the abstract. Establishing a laches defense requires not only evidence of an unreasonable delay before asserting a claim, but also *some* proof of prejudice resulting from the delay. *Gutierriz* v. *Waterman S.S. Corp.*, 373 U. S. 206, 215-16 (1963). At no time during any of the proceedings was any evidence adduced which even suggested prejudice resulted from the timing of Respondents' actions against Petitioners. Petitioners do not now and never did claim the contrary. Thus, not only is the question of laches not procedurally presented; it is not factually presented either.

(3) *Conflict.* Procedural and factual inadequacies aside, the Court of Appeals' answer to Petitioners' question is not in conflict with any other court of appeals decision. *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962), the only court of appeals decision cited by Petitioners[2] (at page 18), was a §10(b) action for rescission. The trial court held the defenses of waiver, estoppel and laches unavailable. The Court of Appeals for the Ninth Circuit reversed, holding that nothing in §10(b) indicated

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2. The Court of Appeals decision in *Tobacco and Allied Stocks, Inc.* v. *Transamerica Corp.*, 244 F. 2d 902 (3d Cir. 1957), did no more than adopt the routine approach and apply laches as a defense to an equitable claim.

The only case holding to the contrary of the present Court of Appeals statement is a district court decision, *Pitofsky* v. *Brucker*, CCH FED. SEC. L. REP. ¶91,715 (S.D.N.Y. 1966), cited by Petitioners at 18. That case involved an action for damages under Rule 10b-5, but the court's holding at the pleading level that defendant should be given an opportunity to show laches was made without any analysis or discussion, and was only an alternative ground for the decision. The existence of this case certainly is not sufficient justification to obtain this Court's consideration.

an intent to exclude the "traditional" defenses. It said nothing concerning the employment of laches as a defense in legal actions or actions tried at law to a jury as Petitioners subtly imply. In effect, the Court was holding only that the "normal defenses" otherwise available at common law were available against claims made under §10(b).[3]

Aside from the lack of conflict, the Court of Appeals view was clearly correct. And *Straley* v. *Universal Uranium & Milling Corp.*, 289 F. 2d 370 (9th Cir. 1961), holding the defense of laches inapplicable where the action is one at law, is in accord. The Court of Appeals properly stated that the applicable measure of the timeliness of the suit was the Minnesota statute of limitations, and the trial judge correctly instructed on that basis. See *Holmberg* v. *Armbrecht*, 327 U. S. 392, 395 (1946):

> "As to actions at law, the silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation."

The mere fact that Respondents' original prayer asked for equitable relief does not require that equitable defenses be applied to the alternatively requested *legal* relief to which Respondents were entitled. See *Lydle* v. *Scott*, 157 F. Supp. 729 (N.D. Ohio 1957).

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3. A careful reading of *Royal Air Properties, Inc.* v. *Smith* and *Tobacco and Allied Stocks, Inc.* v. *Transamerica Corp.*, 143 F. Supp. 323 (D. Del. 1956), *aff'd*, 244 F. 2d 902 (3d Cir. 1957), reveals that neither court was faced with the question posed here by Petitioners: *i.e.*, whether laches is available as a defense in actions at law. Both courts did state that characterizations of claims in the complaint as "legal" would not be dispositive of whether equitable defenses might be available. With this principle, Respondents have no quarrel.

C. The Court of Appeals observation on "scienter," an issue not actually presented to it, does not conflict with any court of appeals decision.

Petitioners attempt to raise for review the question whether "proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made," is required in a §10(b) action.[4] (Petition 11.) The Court should deny review because (1) Petitioners failed to properly raise scienter as an issue before the Court of Appeals; (2) Petitioners' theory of scienter is logically inapplicable to the facts of this case; (3) no con-

4. The casual reference by Petitioners to commentators as requiring "some degree of scienter" (Petition at 15), subtly attempts to water down the burden of supporting the assertion that the district court erred when it failed to instruct the jury using their theory of scienter as embodied in their requested instructions (Request Nos. 1(2) and 5 at R. 834, 836). If those instructions are incorrect there is no error in refusing to give them. *Baltimore & O. Ry.* v. *Felgenhauer*, 168 F. 2d 12, 18 (8th Cir. 1948). None of the commentators cited would support anything like the instructions Petitioners requested. Thus, 3 Loss, SECURITIES REGULATION 1766 (2d ed. 1961) observes that the courts may require, not "scienter," but "some sort of watered-down *scienter* element." Such a requirement could well be satisfied by showing "constructive fraud," i.e., making a statement with reckless disregard of its truth or falsity, *Trussel* v. *United Underwriters, Ltd.*, 228 F. Supp. 757, 772 (D. Colo. 1964), just as the requirement that an act be done "willfully" may be satisfied by showing it was done "without justifiable excuse," "stubbornly, obstinately, perversely," or with "careless disregard whether or not one has the right to so act," *United States* v. *Murdock*, 290 U. S. 389, 394 95 (1933). Comment, *Negligent Misrepresentations Under Rule 10b-5*, 32 U. CHI. L. REV. 824, 838 (1965). The balance of the authorities support the court's refusal to instruct. Fleischer, *"Federal Corporation Law": An Assessment*, 79 HARV. L. REV. 1146, 1178 and n. 147 (1965) states only that "some degree of wilfullness" may be required and that " 'constructive' knowledge is enough, *i.e.*, that the defendant should have known of the misstatement." The author of Note, 63 MICH. L. REV. 1070 (1965) concludes that plaintiff need only show that "considering all the circumstances, and particularly that of accessibility to the facts, the defendant did not act as would the ordinarily prudent person to avoid misrepresentation, either express or by omission." 63 MICH. L. REV. at 1079.

flict with any Court of Appeals decision exists; and (4) the lower courts' case-by-case development of the law on this issue is satisfactory.

(1) *Preservation.* The issue of scienter is improperly presented as a question in this case in that Petitioners did not raise it on appeal before the Court of Appeals. They may not properly raise it here, having (understandably, in light of the evidence)[5] abandoned it there.[6] *California* v. *Taylor, supra,* 353 U. S. 553, 556 n. 2 (1957).

(2) *Inapplicability.* Because they were not present at trial, it is understandable that present Counsel for Petitioners could overlook the fact that their theory of "scienter" could not logically apply to the facts of the case. The trial court's refusal to instruct on "scienter" (as

5. It is inconceivable that the jury could have found under any circumstances, that the representations or omissions were innocent, as claimed by Petitioners (Petition at page 14). On the one hand, Respondents claimed that definite and affirmative misrepresentations were made concerning the financial condition and prospects of LPE; on the other hand, Petitioners Benn and Phil Myzel both claimed that no representations of any kind were made. No middle ground having been presented, it was merely a question of whom to believe. Naturally, the veracity and credibility of the witnesses was left to the jury. But some idea of the weight which could be accorded to these Petitioners' testimony can be obtained by glancing through a few pages of it. See, *e.g.,* R. 577-80, 584-85, 597-98, 661-64, 672-73. It is no small wonder that the "jurors determined the plaintiffs were telling the truth and that defendants were not." Opinion of United States District Court at A. 62. The District Court observed that it "could add its own evaluation of the credibility of some of the defendants, but * * * [would] refrain from doing so." *Ibid.* And the Court of Appeals described Petitioners' testimony as "taxing even the most credulous mind" (A. 23).

6. The observations made by the Court of Appeals on the doctrine of scienter were prompted by Petitioners' confusing claim before that court that scienter to some extent governed the *measure of damages* (App. Br. 59-62). This claim is of an entirely different nature than the new claim (not argued, briefed or assigned as error before the Court of Appeals) that scienter is a necessary requisite for establishing *liability.*

Petitioners understand the term) is supported not only on the ground that such "scienter" is not requisite of a §10(b) case, but also on the ground that any representations or omissions were, as a matter of law, made with knowledge of the falseness of the impressions they produced. The jury found false or misleading misrepresentations or omissions about the financial condition and value of LPE and the future position of Benn Myzel in LPE stock. Contrary to Petitioners' claim that these misrepresentations or omissions could have been inaccurately but nevertheless "honestly" made (see Petition at 14), the actual testimony of Messrs. Myzel shows without contradiction that each knew that the opposite of the impressions produced by the misrepresentations or omissions was true. Petitioner Benn Myzel insisted that he was *"always"* optimistic about the company (R. 612, 636), *"always"* felt it had a "bright future" and would be a success, and *"Knew,* too, that business was going up as far as sales" (R. 612). [Emphasis added.] Petitioner Phil Myzel testified that he *"knew"* the company's stock "eventually * * * would be worth something," and that he "had faith in the boys" (R. 683) [emphasis added], and that Benn Myzel had advised him that they should "hang onto" their stock because the company "eventually * * * will be all right" (S.R. 395). The verdict establishes that false or misleading representations or omissions were made. They could not be made innocently by witnesses who insist they "knew" otherwise.

(3) *Conflict.* In addition to the foregoing reasons for denying review, no real and embarrassing conflict exists between courts of appeals. No court of appeals has held to the contrary of the statement by the Court below that "proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made,

is not required under Section 10(b) of the Act" (A. 19). Petitioners assert that *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951), holds that such "scienter" is required for a §10(b) action. It is clear it does not. The question in that case was whether *purchasers* of stock could recover under §10(b) for misrepresentations and omissions in prospectuses and registration statements made unlawful by §11 of the Securities Act of 1933, 15 U.S.C. §77k. The trial court held that they could not, reasoning that since Congress imposed restrictions on a §11 action, *e.g.*, a short statute of limitations and discretion in the court to require security, it could not have intended that recovery be had under §10(b) for the same conduct, free of the procedural restrictions. The Court of Appeals reversed, saying:

> "A suit under §11 of the 1933 Act requires no proof of fraud or deceit, and such a suit may be maintained only by one who comes within a narrow class of persons, *i.e.*, those who purchase securities that are the direct subject of the prospectus and registration statement (here the purchasers of preferred stock). But proof of fraud is required in suits under §10(b) of the 1934 Act and Rule X-10B-5 [citing "Cf. Norris & Hirschberg, Inc. *v.* S.E.C., 85 U. S. App. D.C. 268, 177 F. 2d 228, 230; Ward LaFrance Truck Corporation, 13 S.E.C. 372, 381 note"], which was validly promulgated by the S.E.C. pursuant to that section. Congress, reasonably, and without inconsistency, allowed suits of that sort which (1) are free of the restrictions applicable to a suit under §11 of the 1933 Act and (2) which are not confined to those persons who may properly sue under that section but which include all who are victims of the fraud. We think that when, to conduct actionable under §11 of the 1933 Act,

> there is added the ingredient of fraud, then that conduct becomes actionable under §10(b) of the 1934 Act and the Rule, at the suit of any defrauded person, whether or not he could maintain a suit under §11 of the 1933 Act." 188 F. 2d at 786-87.

It will be noted that the court did not say "scienter" was required, but that "fraud" was.[7] Contrary to Petitioners' unexplained assumption;[8] the terms are not identical.[9] That the *Fischman* court did not equate them is shown by considering the cases it cited supporting the proposition that proof of "fraud" is required in §10(b) actions. See BROMBERG, SECURITIES LAW: FRAUD §2.4(2) at page 35. In *Norris & Hirschberg, Inc.* v. *SEC*, 177 F. 2d 228 (D.C. Cir. 1949), the court affirmed an SEC finding that a corporation had violated Rule 10b-5, concluding that despite the fact that petitioner's conduct did not involve common law fraud, still it could "only be described as manipulative, deceptive and fraudulent," and that

> "To say, as petitioner does, that every element of common law fraud must be proven * * * is to say that Congress had no purpose in enacting regulatory statute in this field and that its legislation is meaningless." 177 F. 2d at 233.

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7. The facts made it unnecessary for the *Fischman* court to direct itself to the question whether the "fraud" to which it referred required "scienter," in the sense urged by Petitioners here. The plaintiffs in *Fischman* were prepared to prove the representations in question "were wilfully and knowingly misleading"—fraud under any test. 188 F. 2d at 785.

8. "In those circumstances, there would be no fraud—*i.e.*, no 'scienter' * * *" (Petition 11).

9. The District Court herein recognized this, stating that "The language used [in the Act and Rule 10b-5] is broader than the common terms of fraud or misrepresentation. The latter terms are used by lawyers and courts and will be used here" (A. 59).

In *Ward LaFrance Truck Corp.*, 13 S.E.C. 373 (1943), the Commission referred to Rule 10b-5 as an "antifraud" provision (13 S.E.C. at 381 n.), but showed it did not mean "fraud" in the common-law sense by including no findings or discussion as to "scienter" to support its conclusion that 10b-5 had been violated. It emphasized only that the insiders' nondisclosure "placed the stockholders at a distinct disadvantage" (13 S.E.C. at 379), and "*acted as* a deceit" upon them (13 S.E.C. at 380). [Emphasis added.]

That *Fischman* is not in "real and embarrassing conflict" with the Court of Appeals statement herein is shown by the fact that several district courts in the Second Circuit agree that "scienter" is not a prerequisite of §10(b) recovery. *Miller* v. *Steinbach*, 268 F. Supp. 255, 279 (S.D.N.Y. 1967); *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 277-78 (S.D.N.Y. 1966); *Dack* v. *Shanman*, 227 F. Supp. 26, 29 (S.D.N.Y. 1964). *But see, Richland* v. *Crandall*, 262 F. Supp. 538, 553 n. 12 (S.D.N.Y. 1967); *Weber* v. *C.M.P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965); *Thiele* v. *Shields*, 131 F. Supp. 416, 419 (S.D.N.Y. 1955). If there is confusion among the district courts in the Second Circuit,[10] that is a matter of concern to the Court of Appeals for the Second Circuit, not this Court.

Except for the three Southern District of New York cases just cited, all courts agree that "scienter" is not required in §10(b) actions. *Stevens* v. *Vowell*, 343 F. 2d 374, 379-80 (10th Cir. 1965); *Kohler* v. *Kohler Co.*, 319

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10. *Fischman* apparently confuses even the courts in the "commercial and financial center" which deal "with a significant number of all actions brought under Rule 10b-5." (See Petition 12.)

The courts of appeals were established for the express purpose of relieving this Court of supervision over district court decisions. ROBERTSON & KIRKHAM, JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES §325, at p. 637 (Wolfson & Kurland ed. 1951).

F. 2d 634, 637 (7th Cir. 1963), *affirming* 208 F. Supp. 808, 822 (E.D. Wis. 1962); *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210, 212 (9th Cir. 1962); *Ellis* v. *Carter,* 291 F. 2d 279, 273-74 (9th Cir. 1961); *Barles* v. *Bear, Stearns & Co.,* CCH FED. SEC. L. REP. ¶91,674 (N.D. Ill. 1966); *Pappas* v. *Moss,* 257 F. Supp. 345, 363 n. 5 (D.N.J. 1966); *Carliner* v. *Fair Lanes, Inc.,* 244 F. Supp. 25, 28-29 (D. Md. 1965); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.,* 187 F. Supp. 14, 22-24 (W.D. Ky. 1960), *reversed on other grounds,* 307 F. 2d 242 (6th Cir. 1962). Petitioners claim that the District Court for the District of Colorado, in *Parker* v. *Baltimore Paint & Chemical Corp.,* 244 F. Supp. 267 (D. Colo. 1965), and *Trussel* v. *United Underwriters, Ltd.,* 228 F. Supp. 757 (D. Colo. 1964), required scienter; it is plain, however, that it did not use the term "scienter" in the sense Petitioners do. The court specifically stated that "constructive fraud," *i.e.,* making a statement with reckless disregard as to whether it is true, is sufficient. 228 F. Supp. at 772.

Moreover, the reasoning of the cases holding scienter not to be required is so cogent and compelling that there is little reason to doubt that all the courts of appeals will adopt it when presented with the question. See *Ellis* v. *Carter, supra,* 291 F. 2d 270, 273-74 (9th Cir. 1961); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co., supra,* 187 F. Supp. 14, 22-24 (W.D. Ky. 1960); see also BROMBERG, SECURITIES LAW: FRAUD §§2.4(2) at page 36, 2.6(1) at page 50, 8.4 at page 203 (1967); Fleischer, *"Federal Corporation Law": An Assessment,* 78 HARV. L. REV. 1146, 1178 n. 147 (1965); Comment, *Negligent Misrepresentations Under Rule 10b-5,* 32 U. CHI. L. REV. 824 (1965); Note, 63 MICH. L. REV. 1070 (1965). The provisions of §10(b) and Rule 10b-5 are certainly no more amenable to construction as

requiring scienter than those of the Investment Advisors Act, 15 U.S.C. §80b-6; this Court has held that it would defeat Congress' manifest purpose to hold that the Advisors Act required proof of intent to injure. *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963).

(4) *Satisfactory Development.* On issues as complex as that raised by the "scienter" question, case-by-case development by lower courts is crucial in determining when a matter is "ripe" for review. It appears that the lower courts are in the process of satisfactorily developing the correct rule in this area on a case-by-case basis. Because of the multiplicity of fact situations to which §10(b) can be applied and the wide range of possible proof requirements which might be formulated (*e.g.*, intent, recklessness, gross negligence, simple negligence, failure to ascertain, complete innocence, and presumptions concerning the same), this Court should have the aid of the fully-developed, articulated and studied thinking of as many courts of appeals as possible before allowing the matter to mature into a determination by this Court. This seems peculiarly appropriate in an area in which it would be "desirable to have different aspects of" the issue "further illumined by the lower courts." *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912, 918 (1950) (opinion of Frankfurter, J. respecting denial of certiorari). A much more appropriate case for review would be one presented after such development has occurred and one in which the issue is squarely presented procedurally and factually.[11]

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11. Petitioners also attempt to raise the question whether the present case must be deemed time-barred, assuming it involved only innocent misrepresentations or omissions (Petition 15). It is much too late for Petitioners to raise this point, not having done so before either the District Court of the Court of Appeals. *Vaughan* v. *Atkinson*, 369 U. S. 527, 531 n.3 (1962); *Quicksall* v. *Michigan*, *supra*, 339 U. S. 660, 666 n.3 (1950); *McCullough* v. *Kammerer Corp.*, 323 U. S. 327, 328-29 (1945).

D. There is no reason to grant review of the holding that corporate defendant could be liable for violations of §10(b).

Petitioners urge review of the judgment against the corporate defendant on the simple ground that it cannot be charged with

> "misrepresentations or omission made by an officer or director in connection with the selling or buying of the stock * * *" (Petition 21).

On this unimportant and routine issue, Petitioners do not even *assert* a conflict. The only case they cite is *Kohler* v. *Jacobs,* 138 F. 2d 440, 443 (5th Cir. 1943), holding that a corporation *could* be deemed liable where stock is procured for it through its officer's fraud—an unlikely reason for review. Moreover, regardless of the rule Petitioners invoke with respect to situations where an officer or director buys only for his own personal account, *Kohler* v. *Jacobs,* 138 F. 2d 440, 443 (5th Cir. 1943) (dicta); 10 FLETCHER, CYCLOPEDIA CORPORATIONS §4886 at 506 (Rev. ed. 1961), the rule is certainly different where, as here, an insider buys for the corporation, the stock is in fact delivered to the corporation, and the corporation makes payments therefor. It is clear that the §10(b) principles of liability "apply not only to majority stockholders of corporations and corporate insiders, but equally to corporations themselves when acting through their officers, directors, or agents."[12] *Kohler* v. *Kohler Co.,* 319 F. 2d 634, 638 (7th Cir. 1963); see *Kohler*

12. An alternative ground for holding the corporation liable is the principle that a "controlling person" may be held liable for failure to prevent misconduct by those within such person's control. See, *e.g., Brennan* v. *Midwestern United Life Ins. Co.,* 259 F. Supp. 673, 680-82 (N.D. Ind. 1966) (corporation); *Lorenz* v. *Watson,* 285 F. Supp. 724, 733 (E.D. Pa. 1966) (individual).

v. *Jacobs, supra,* 138 F. 2d 440, 442-43 (5th Cir. 1943). It is also plain that the fact that the shares were retired rather than resold is immaterial, in that a party may be held responsible for tortious wrongdoing although he realized no benefit from it. See *James-Dickinson Farm Mortgage Co.* v. *Harry,* 273 U. S. 119, 123 (1926), and cases cited; *Fischer* v. *Kletz,* 266 F. Supp. 180, 187-88, 193 (S.D.N.Y. 1967) (§10(b) case). There is nothing in Petitioners' suggestion (page 21) that "since 1962, 150,000 additional shares of LII have been issued to the public,"[13] which changes the application of these principles. The Court of Appeals was clearly correct in saying:

> "The fact that bona fide public stockholders might indirectly be prejudiced by the corporation's payment of indebtedness incurred by a predecessor corporation is not persuasive. Stockholders are presumed to invest with knowledge of proper corporate liabilities. If any harm exists by reason of the corporation's legal liabilities wrongfully caused by its officers or directors, such damage can be corrected through proper proceedings" (A. 50-51).

Petitioners raise no point upon which any conflict in decisions exists, and otherwise show no reason justifying this Court's consideration.

E. No conflict exists because the Court of Appeals did *not* hold that a "grossly negligent plaintiff" may recover under Rule 10b-5.

The conflict Petitioners suggest and their argument at pages 21-22 is premised entirely on the assumption that "Respondent Vertelney was found by the Court of Appeals to have been, if anything, 'grossly negligent'" (A. 23).

13. There is no indication who comprises this "public."

This assumption is false, and is based on nothing but a gross mischaracterization of what the Court of Appeals said. The Court's statement must be read in the context of its entire discussion. See A. 22-25. Such a reading clearly shows that the Court of Appeals held that given the circumstances *"in this particular case"* (A. 23), Vertelney was properly found to have acted reasonably. The Court spoke of "gross negligence" only to provide its assessment of the hypothetical situation which would have existed had Phil Myzel's statements or nondisclosures concerned only LPE's financial condition and business affairs. However, the Court clearly distinguished this hypothetical situation from that presented to the jury. The Court emphasized that the evidence showed that other important statements and nondisclosures justified the jury's finding of Vertelney's conduct to be reasonable.[14]

Thus, there is utterly no conflict with *List* v. *Fashion Park, Inc.*, 340 F. 2d 457 (2d Cir.), *cert. denied*, 382 U. S. 811 (1965). That case held that a plaintiff may not recover if it appears as a matter of law he would have acted no differently had he known the falsity of the representations and the existence of the facts omitted.[15] With this propo-

14. The Court emphasized that the evidence justified findings: (1) that Phil Myzel's affirmative statement that Benn Myzel "doesn't think they are going anywhere" and was "going to get out" were very important to Vertelney, since Benn Myzel was Vertelney's trusted friend and advisor and, as Vertelney knew, was intimately involved with the corporation; (2) that Phil's failure to disclose the true purchasers was very significant; (3) that the "labyrinthine transfers" used to conceal the transaction caused the true identity of the purchaser to be "effectively hidden from even a most alert director or insidr"; and (4) that "under the particular setting involved that there was created a diminished necessity" to make inquiry such as would have been required had Phil Myzel's representations and omissions related strictly and only to the affairs of LPE. See A.22-25.

15. Respondents would also agree with the dicta in *List* which suggest that recovery may not be had unless the individual plaintiff actually relies upon statements or omissions upon which a reasonable man, in the same circumstances, could rely. *List* v. *Fashion Park, Inc., supra* at 462. As noted above, the jury was held to have properly found Vertelney acted reasonably.

sition Respondents agree. It is clear that the jury herein properly found Vertelney would not have sold his stock had he known the falsity of the representations and the existence of the matters omitted. Petitioners' citation of *Hafner* v. *Forest Laboratories, Inc.*, 345 F. 2d 167 (2d Cir. 1965), for the proposition that a plaintiff whose claim is based on facts which were equally available to both buyer and seller may not recover, is completely inapposite; Phil Myzel made affirmative representations as to Benn Myzel's actions and views, and failed to disclose the true purchasers, which facts certainly were not as available to Vertelney as they were to Phil Myzel.

F. The holding on measure of damages does not conflict with any court of appeals decision.

Petitioners assert (at 16) that "in permitting recovery by the sellers of an amount greater than the difference between the value of the stock at the time of sale and the amount of consideration received," the courts below reached a result which "conflicts" with *Estate Counselling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962). This inexcusably ignores the fact that *Estate Counselling Service* applied the "out-of-pocket" rule to a §10(b) case brought by a *purchaser* of stock. That holding in no way governs §10(b) cases bought by *sellers* of stock, and it is clear that a different rule should apply in such cases. Where a defrauded *purchaser* of stock is the plaintiff, subsequent history of the stock is not germane to his damages. The purchaser in such a case loses nothing other than the definite amount of money which he paid when purchasing the stock. Assuming the defrauded *seller* of stock would have retained it had he known the true state of affairs, he loses

whatever appreciation in value of the stock occurs between the time of sale and time of discovery of the fraud.[16] Any measure of damages must take into account this difference. The differences between purchasers and sellers are carefully explained in *Janigan* v. *Taylor*, 344 F. 2d 781 (1st Cir.), *cert. denied*, 382 U. S. 879 (1965):

> "With respect to damages we draw a distinction between cases where, by fraud, one is caused to buy something that one would not have bought or would not have bought at that price, and where, by fraud one is induced to convey property to the fraudulent party. In the former case the damages are to be reckoned solely by 'the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to defendant's conduct, but not damages covering "the expected fruits of an unrealized speculation."' Sigafus *v.* Porter, 1900, 179 U. S. 116 * * * See Estate Counselling Service, Inc. *v.* Merrill Lynch, Pierce, Fenner & Smith, Inc. * * * On the other hand, if the property is not bought, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." 344 F. 2d at 786.[17]

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16. In fact, the jury was further limited in the instruction to a "reasonable period" subsequent to the sale (R. 893).

17. Petitioners claim (Petition 17) that "the *Janigan* rule is one which is specifically applicable only to 'conscious wrongdoers,'" is inaccurate. *Janigan* involved such a wrongdoer, but the court nowhere suggested its measure of damages was limited to such facts (even if it had, it would have been mere dicta and thus could not

These crucial differences are not considered in *Kohler* v. *Kohler Co.*, 208 F. Supp. 808 (E.D. Wis. 1963), (which was decided prior to *Janigan* v. *Taylor, supra*) cited by Petitioners at pages 17. That court held that under §10(b) the plaintiff there had failed to prove any wrongful conduct. The court's gratuitious statement that plaintiff "suffered no damage" because the stock was worth no more than what was paid, was an alternative ground totally ignored by the Court of Appeals for the Seventh Circuit on appeal. Accordingly, since neither *Estate Counselling Service* nor *Kohler* are *contra* to the present case there is no conflict among the courts of appeals.

The only courts of Appeals which have really faced the issues in this case are the First Circuit in *Janigan* v. *Taylor, supra,* and the Eighth Circuit in the present case. Both reached the same result. But an issue of this nature, involving the marked distinctions between a sale of tangible property and a sale of fungible intangibles with volatile values, should receive treatment at the trial court level before the measure of damages in all its ramifications can be considered "ripe" for review by this Court. The measure of damage should be allowed to "operate" in instruction form or by application by deciding courts. Moreover,

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have created a conflict). There is no reason to doubt that the *Janigan* court, when employing the terms "fraud," "fraudulent," and "defrauded," was using them as words of art, rather than in their common-law sense. See discussions at pages 21n. 4, 25-26. Further, it is much too late for Petitioners to raise this point. They did not request the trial court to instruct the jury that a different measure of damages would apply if the "wrongdoing" was "conscious." Nor did they object to the absence of such an instruction. Moreover, Petitioners' statement that there may have been no "scienter" in this case is erroneous. As explained above, pages 22-23 *supra,* it appears as a matter of law in this case that the misrepresentations or omissions were made with knowledge of the false or misleading nature of the impression they produced.

the nuances of the market for securities must be given full play in order that all the issues involved in applying a measure of damages can be distilled to something more than abstract application in a case involving the issue in a condition of first impression. It would be helpful if this type of prior consideration and amplification by the lower courts occurred before this Court reviewed the matter.

Moreover, the result reached by the courts below is the correct one. Petitioners state:

> "In fashioning an implied right of action under the general standards of Rule 10b-5, the lower courts have created, and are creating, a body of Federal corporate common law, much like the development of Federal law before *Erie R. R.* v. *Tompkins,* 304 U. S. 64 (1938). The measure of damages historically adopted in Federal cases involving common law actions for fraud and deceit has been the 'out-of-pocket' rule." (Petition 16.)

This is a nonsequitur. That federal courts are creating a body of law under §10(b) certainly does not mean that they must rigidly adhere to standards formulated when creating another body of law, *i.e.* federal common law. The intention of Congress under the Act was that the remedies in civil actions "should be in addition to any and all other rights and remedies that may exist at law or in equity." Securities Exchange Act of 1934, §28(a), 15 U.S.C. §78bb(a). In *Chicago Board of Trade* v. *Johnson,* 264 U. S. 1 (1924), this court found that federal policy evidenced by federal statutes overrides and dominates general common law principles.

> "[W]hen the language of Congress indicates a policy requiring a broader construction of the statute

> than the state decisions would give it, Federal Courts cannot be concluded by them." 264 U. S. at 10.

Thus, in *SEC* v. *Capital Gains Research Bureau,* 375 U. S. 180 (1963), this Court stated:

> "There has also been a growing recognition by common law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and, that, accordingly, the doctrines must be adapted to the merchandise in issue." 375 U. S. at 194.

Clearly the trial court and the Court of Appeals in this case adjusted their thinking and the application of the measure of damages to "the merchandise in issue." The instruction, while it might conflict with the venerable but outdated principles of the common law "out-of-pocket" rule under federal law, see *Smith* v. *Bolles,* 132 U. S. 125 (1889), allowed the jury to assess damages properly approximating what was actually lost by the Respondents.[18]

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18. Petitioners' contention that allowing damages greater than those permitted under an out-of-pocket rule conflicts with §28(a) of the Securities Exchange Act, 15 U.S.C. §78bb(a) limiting recovery to "actual damages on account of the act complained of," begs the question. An appropriate measure of damages assumes that "actual damages" are being assessed. The Court of Appeals was clearly correct in stating that:

> "[W]e feel the only effect of this provision is to prohibit punitive damages, which otherwise might be available in some states in civil actions under the Securities Exchange Act of 1934." (A. 48).

Conclusion

No conflict prevails among the courts of appeal on any of the "questions presented" by Petitioners. And there appear no novel and important aspects which could lead to the discretionary exercise of the power to review.

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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